



## Senate

General Assembly

**File No. 534**

February Session, 2006

Substitute Senate Bill No. 669

*Senate, April 18, 2006*

The Committee on Finance, Revenue and Bonding reported through SEN. DAILY of the 33rd Dist., Chairperson of the Committee on the part of the Senate, that the substitute bill ought to pass.

***AN ACT CLARIFYING POLICIES REGARDING THE EXPENDITURES ELIGIBLE FOR THE RESEARCH AND DEVELOPMENT TAX CREDIT AND THE SALES TAXATION OF MANUFACTURING MACHINERY AND EQUIPMENT.***

Be it enacted by the Senate and House of Representatives in General Assembly convened:

1 Section 1. Subsection (a) of section 12-217j of the general statutes is  
2 repealed and the following is substituted in lieu thereof (*Effective July*  
3 *1, 2006, and applicable to income years commencing on or after January 1,*  
4 *2006*):

5 (a) (1) There shall be allowed as a credit against the tax imposed on  
6 any corporation under this chapter, with respect to income years of  
7 such corporation commencing on or after January 1, 1994, but prior to  
8 income years commencing on or after January 1, 2006, an amount  
9 equal to twenty per cent of the amount spent by such corporation  
10 directly on research and experimental expenditures, as defined in  
11 Section 174 of the Internal Revenue Code of 1986, or any subsequent

12 corresponding internal revenue code of the United States, as from time  
13 to time amended, which are conducted in this state and which exceeds  
14 the amount spent by such corporation during the preceding income  
15 year of such corporation for such expenditures.

16 (2) There shall be allowed as a credit against the tax imposed on any  
17 corporation under this chapter, with respect to income years of such  
18 corporation commencing on or after January 1, 2006, an amount equal  
19 to thirty per cent of the amount spent by such corporation directly on  
20 research and experimental expenditures, as defined in Section 41 of the  
21 Internal Revenue Code of 1986, as in effect on December 31, 2005,  
22 which are conducted in this state and which exceeds the amount spent  
23 by such corporation during the preceding income year of such  
24 corporation for such expenditures.

25 Sec. 2. Subsections (b) and (c) of section 12-217n of the general  
26 statutes are repealed and the following is substituted in lieu thereof  
27 (*Effective July 1, 2006, and applicable to income years commencing on or after*  
28 *January 1, 2006*):

29 (b) For purposes of this section:

30 (1) "Research and development expenses" means: (A) For those  
31 credits allowed pursuant to this section for expenditures made during  
32 income years commencing prior to January 1, 2006, research or  
33 experimental expenditures deductible under Section 174 of the Internal  
34 Revenue Code of 1986, as in effect on May 28, 1993, determined  
35 without regard to Section 280C(c) [thereof] of said Internal Revenue  
36 Code or any elections made by a taxpayer to amortize such expenses  
37 on its federal income tax return that were otherwise deductible, and  
38 basic research payments as defined under Section 41 of said Internal  
39 Revenue Code to the extent not deducted under said Section 174,  
40 provided: [(A)] (i) Such expenditures and payments are paid or  
41 incurred for such research and experimentation and basic research  
42 conducted in this state; and [(B)] (ii) such expenditures and payments  
43 are not funded, within the meaning of Section 41(d)(4)(H) of said  
44 Internal Revenue Code, by any grant, contract, or otherwise by a

45 person or governmental entity other than the taxpayer unless such  
46 other person is included in a combined return with the person paying  
47 or incurring such expenses; (B) for those credits allowed pursuant to  
48 this section for expenditures made during income years commencing  
49 on or after January 1, 2006, research or experimental expenditures as  
50 defined pursuant to Section 41 of the Internal Revenue Code of 1986, as  
51 in effect on December 31, 2005, determined without regard to Section  
52 280C(c) of said Internal Revenue Code or any elections made by a  
53 taxpayer to amortize such expenses on its federal income tax return  
54 that were otherwise deductible, provided: (i) Such expenditures and  
55 payments are paid or incurred for such research and experimentation  
56 and basic research conducted in this state; and (ii) such expenditures  
57 and payments are not funded, within the meaning of Section  
58 41(d)(4)(H) of said Internal Revenue Code, by any grant, contract, or  
59 otherwise by a person or governmental entity other than the taxpayer  
60 unless such other person is included in a combined return with the  
61 person paying or incurring such expenses;

62 (2) "Combined return" shall mean a combined corporation business  
63 tax return under section 12-223a;

64 (3) "Commissioner" means the Commissioner of Economic and  
65 Community Development;

66 (4) "Qualified small business" means a company that (A) has gross  
67 income for the previous income year that does not exceed one hundred  
68 million dollars, and (B) has not, in the determination of the  
69 commissioner, met the gross income test through transactions with a  
70 related person, as defined in section 12-217w.

71 (c) (1) The amount allowed as a credit in any income year shall be  
72 the tentative credit calculated under subdivision (2) of this subsection,  
73 modified as provided in subsection (e) or (f) of this section, if  
74 applicable, except that in the case of a qualified small business the  
75 tentative credit allowed for research and development expenses shall  
76 be equal to [six] nine per cent of such expenses or in the case of any  
77 business employing over two thousand five hundred people in the

78 state of Connecticut with annual revenues in excess of three billion  
79 dollars and headquartered in an enterprise zone the tentative credit  
80 allowed for research and development expenses shall be equal to the  
81 greater of (A) the tentative credit calculated under subdivision (2) of  
82 this subsection, modified as provided in subsection (e) or (f) of this  
83 section, if applicable, or (B) [three and one-half] five and one-quarter  
84 per cent of such expense.

85 (2) Where the research and development expenses paid or incurred  
86 in the income year equal: (A) Fifty million dollars or less, the tentative  
87 credit allowed shall be an amount equal to [one] one and one-half per  
88 cent of such expenses; (B) more than fifty million dollars but not more  
89 than one hundred million dollars, the tentative credit allowed shall be  
90 equal to five hundred thousand dollars plus [two] three per cent of the  
91 excess of such expenses over fifty million dollars; (C) more than one  
92 hundred million dollars but not more than two hundred million  
93 dollars, the tentative credit allowed shall be equal to one million five  
94 hundred thousand dollars plus [four] six per cent of the excess of such  
95 expenses over one hundred million dollars; and (D) more than two  
96 hundred million dollars, the tentative credit allowed shall be equal to  
97 five million five hundred thousand dollars plus [six] nine per cent of  
98 the excess of such expenses over two hundred million dollars.

99 Sec. 3. (*Effective from passage*) (a) There is established a task force to  
100 study tax relief for manufacturers. Such study shall include, but not be  
101 limited to, (1) an examination of exemptions from the sales and use tax  
102 intended to encourage and facilitate investment in new technologies  
103 and manufacturing machinery and equipment, (2) a review of other  
104 statutory provisions intended to preserve and promote manufacturing  
105 and manufacturing jobs in Connecticut, and (3) development of  
106 recommendations to provide clarity and consistency in the application  
107 of such exemptions and other statutory provisions.

108 (b) The task force shall consist of the following members:

109 (1) Two representatives of a state-wide business group appointed by  
110 the speaker of the House of Representatives;

111 (2) Two representatives of a state-wide manufacturers' group  
112 appointed by the president pro tempore of the Senate;

113 (3) One representative of a labor group appointed by the majority  
114 leader of the House of Representatives;

115 (4) One representative of a labor group appointed by the majority  
116 leader of the Senate;

117 (5) One representative from municipal government appointed by  
118 the minority leader of the House of Representatives;

119 (6) One representative from municipal government appointed by  
120 the minority leader of the Senate;

121 (7) The Commissioners of Revenue Services and Economic and  
122 Community Development, or the commissioners' designees;

123 (8) Two representatives from quasi-public agencies concerned with  
124 economic development appointed by the Governor; and

125 (9) The chairpersons of the joint standing committees of the General  
126 Assembly having cognizance of matters relating to commerce and  
127 finance, revenue and bonding.

128 (c) Any member of the task force appointed under subdivision (1),  
129 (2), (3), (4), (5) or (6) of subsection (b) of this section may be a member  
130 of the General Assembly.

131 (d) All appointments to the task force shall be made no later than  
132 thirty days after the effective date of this section. Any vacancy shall be  
133 filled by the appointing authority.

134 (e) The speaker of the House of Representatives and the president  
135 pro tempore of the Senate shall select the chairpersons of the task  
136 force, from among the members of the task force. Such chairpersons  
137 shall schedule the first meeting of the task force, which shall be held no  
138 later than sixty days after the effective date of this section.

139 (f) The administrative staff of the joint standing committee of the  
 140 General Assembly having cognizance of matters relating to finance,  
 141 revenue and bonding shall serve as administrative staff of the task  
 142 force.

143 (g) Not later than January 1, 2007, the task force shall submit a  
 144 report on its findings and recommendations to the joint standing  
 145 committees of the General Assembly having cognizance of matters  
 146 relating to finance, revenue and bonding, and economic and  
 147 community development, in accordance with the provisions of section  
 148 11-4a of the general statutes. The task force shall terminate on the date  
 149 that it submits such report or January 1, 2007, whichever is later.

This act shall take effect as follows and shall amend the following sections:		
Section 1	<i>July 1, 2006, and applicable to income years commencing on or after January 1, 2006</i>	12-217j(a)
Sec. 2	<i>July 1, 2006, and applicable to income years commencing on or after January 1, 2006</i>	12-217n(b) and (c)
Sec. 3	<i>from passage</i>	New section

**FIN** Joint Favorable Subst.

The following fiscal impact statement and bill analysis are prepared for the benefit of members of the General Assembly, solely for the purpose of information, summarization, and explanation, and do not represent the intent of the General Assembly or either House thereof for any purpose:

### ***OFA Fiscal Note***

#### ***State Impact:***

Agency Affected	Fund-Effect	FY 07 \$	FY 08 \$
Department of Revenue Services	GF - None	See Below	See Below

Note: GF=General Fund

***Municipal Impact:*** None

#### ***Explanation***

##### ***R&D Credits***

The bill conforms Connecticut's basis for research and development (R&D) credits to the federal R&D credit. It is not expected to have a net revenue impact because the revenue gain associated with narrowing the type of R&D expenses that qualify for a tax credit is expected to offset the revenue loss associated with increasing the percentage of R&D expenditures that a company can claim as a credit by 50%.

The impact to individual companies will vary depending on the level of R&D expenses that qualify under §41 and §174 of the Internal Revenue Code (IRC). For example, the bill will be favorable to companies that have large amounts of expenses that qualify for the IRC §41 tax credit compared to those that qualify for the IRC §174 tax deduction. However, companies will be at a disadvantage if they have small amounts expenses that qualify for the IRC §41 credit compared to those that qualify for the IRC §174 deduction.

The bill is expected to result in some administrative savings to the Department of Revenue Services (DRS) because DRS will be able to verify information on tax returns more easily.

##### ***Manufacturers' Tax Relief Task Force***

The creation of a taskforce is not anticipated to result in a fiscal impact.

***The Out Years***

The annualized ongoing fiscal impact identified above would continue into the future subject to inflation.



**OLR Bill Analysis****sSB 669****AN ACT CLARIFYING POLICIES REGARDING THE EXPENDITURES ELIGIBLE FOR THE RESEARCH AND DEVELOPMENT TAX CREDIT AND THE SALES TAXATION OF MANUFACTURING MACHINERY AND EQUIPMENT.****SUMMARY:**

This bill narrows the types of research and development (R&D) expenses, and reduces the amount of contract research expenses, for which a company can claim either of the state's two R&D corporation tax credits. Under the bill, a company may claim only those expenses that are eligible for a federal R&D tax credit. Under current law, a company can claim a state credit for any research and experimentation expenses that federal tax law allows it to deduct on its federal return.

On the other hand, the bill increases the rates for both state R&D tax credits by 50%. It increases the incremental R&D credit from 20% to 30% of a company's annual increases in R&D spending. It increases the non-incremental ("rolling") R&D credit, which varies depending on the amount of R&D spending in Connecticut and the company's size, from a range of 1% to 6% of eligible R&D spending to 1.5% to 9% of that spending.

The bill applies to R&D tax credits for eligible R&D expenses that companies make in income years starting on or after January 1, 2006.

The bill also establishes a 16-member task force to study tax relief for manufacturers and report to the Finance, Revenue and Bonding and Commerce committees by January 1, 2007.

**EFFECTIVE DATE:** The R&D credit changes are effective July 1, 2006 and apply to income years starting on or after January 1, 2006.

The task force provision takes effect on passage.

## **§§ 1 & 2 - R & D TAX CREDITS**

### ***R&D Expense Limit***

Current law allows a company to claim a state R&D tax credit for any R&D expenses federally deductible under § 174 of the Internal Revenue Code (IRC). The federal law and its accompanying regulations allow a company to deduct any reasonable R&D expense it incurs in connection with its trade or business. The costs must be for R&D “in the experimental or laboratory sense” and generally include all costs “incident to the development or improvement of a product,” such as attorneys’ fees spent to obtain a patent (Treas. Reg. § 1.174-2(a)).

The bill limits the expenses eligible for a state R&D credit by tying them to the expenses for which the company can receive a federal R&D credit under IRC § 41. That law limits eligible expenses to the following:

1. for in-house research, (a) wages paid to employees performing qualified research, (b) supplies, other than real estate and depreciable property, used in the research, and (c) amounts paid for the right to use computers in the research; and
2. for contract research, 65% of the amount paid to any person other than an employee, or 75% of the amount paid to a qualified research consortium, for the research.

Among the types of expenses currently eligible for a state R&D credit that the bill would exclude are:

1. fringe benefits and certain other costs, such as training and travel expenses, for employees conducting R&D;
2. maintenance, rent, utilities, and insurance for facilities or parts of facilities used in R&D;
3. depreciation expenses for R&D equipment;

4. property taxes for R&D-related property; and
5. R&D-related legal and consulting fees, including patent attorneys' fees.

Under both current law and the bill, to be eligible for a state R&D credit, expenses must occur in Connecticut.

### **R&D Credit Increase**

The state has two R&D credits, incremental and non-incremental. The bill increases the credit percentages for both by 50%.

The incremental R&D credit provides a credit equal to a percentage of a company's increase in direct expenses for R&D conducted in Connecticut over its previous year's expenses. The bill raises the credit from 20% to 30% of the annual increase.

The non-incremental ("rolling") R&D credit provides a tax credit equal to a percentage of R&D spending in Connecticut. The percentage varies according the amount of R&D spending or, in certain cases, company size and number of employees. The bill increases the credit range from 1%-6% to 1.5%-9% (see Table 1).

**TABLE 1: CURRENT AND PROPOSED NON-INCREMENTAL R&D CREDITS**

<b>Annual R&amp;D Spending/ Company Size</b>	<b>Non-Incremental R&amp;D Credit</b>	
	<b>Current Law</b>	<b>The Bill</b>
\$50 million or less	1%	1.5%
Over \$50 million to \$100 million	\$500,000 + 2% of the excess over \$50 million	\$500,000 + 3% of the excess over \$50 million
Over \$100 million to \$200 million	\$1.5 million + 4% of the excess over \$100 million	\$1.5 million + 6% of the excess over \$100 million
Over \$200 million	\$5.5 million + 6% of the excess over \$200 million	\$5.5 million + 9% of the excess over \$200 million
Qualified small business (annual gross income \$100 million or less)	6%	9%
Business employing over 2,500 with annual revenue over \$3 billion and headquartered in an enterprise zone	At least 3.5%	At least 5.25%

### § 3 – MANUFACTURERS’ TAX RELIEF TASK FORCE

The bill establishes a 16-member task force to study tax relief for manufacturers. The task force must:

1. examine sales and use tax exemptions intended to encourage and make it easier to invest in new technologies and manufacturing machinery and equipment,
2. review laws intended to preserve and promote manufacturing and manufacturing jobs in the state, and
3. develop recommendations to provide clarity and consistency in the application of the exemptions and laws.

The task force members are the (1) Finance, Revenue and Bonding and Commerce Committee chairmen; (2) the revenue services and economic and community development commissioners or their designees; and (3) 10 members representing various groups appointed by the governor and legislative leaders (see Table 2).

**TABLE 2: MANUFACTURING TAX RELIEF TASK FORCE APPOINTEES**

<b>No.</b>	<b>Representing</b>	<b>Appointed by</b>
2	State wide business group	House speaker
2	State wide manufacturers’ group	Senate president pro tempore
1	Labor group	House majority leader
1	Labor group	Senate majority leader
1	Municipal government	House minority leader
1	Municipal government	Senate minority leader
2	Quasi-public agencies	Governor

Any task force member who is appointed by a legislative leader may be a legislator. Appointing authorities must make their appointments within 30 days after the bill’s passage. Vacancies are filled by appointing authorities. The House speaker and the Senate president pro tempore select the task force chairmen from among the members. The chairmen must schedule the first meeting within 60 days after the bill’s passage.

The task force must report to the Finance, Revenue and Bonding

and Commerce committees by January 1, 2007. It goes out of existence on that date or the date it delivers its report, whichever is later. The Finance, Revenue and Bonding Committee staff serves as the task force staff.

**COMMITTEE ACTION**

Finance, Revenue and Bonding Committee

Joint Favorable Substitute

Yea    31        Nay   18        (04/03/2006)